

***United States Court of Appeals
for the Second Circuit***



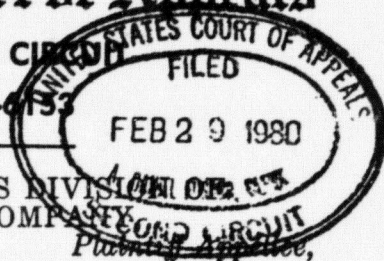
**APPELLANT'S
BRIEF**

w/ affidavit
77-6153

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 77-6153



BRISTOL LABORATORIES DIVISION OF
BRISTOL-MYERS COMPANY

—v.—

ELMER B. STAATS, Comptroller General of the
United States,
Defendant-Appellant,

—and—

UNITED STATES OF AMERICA,
Intervenor-Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF APPELLANTS

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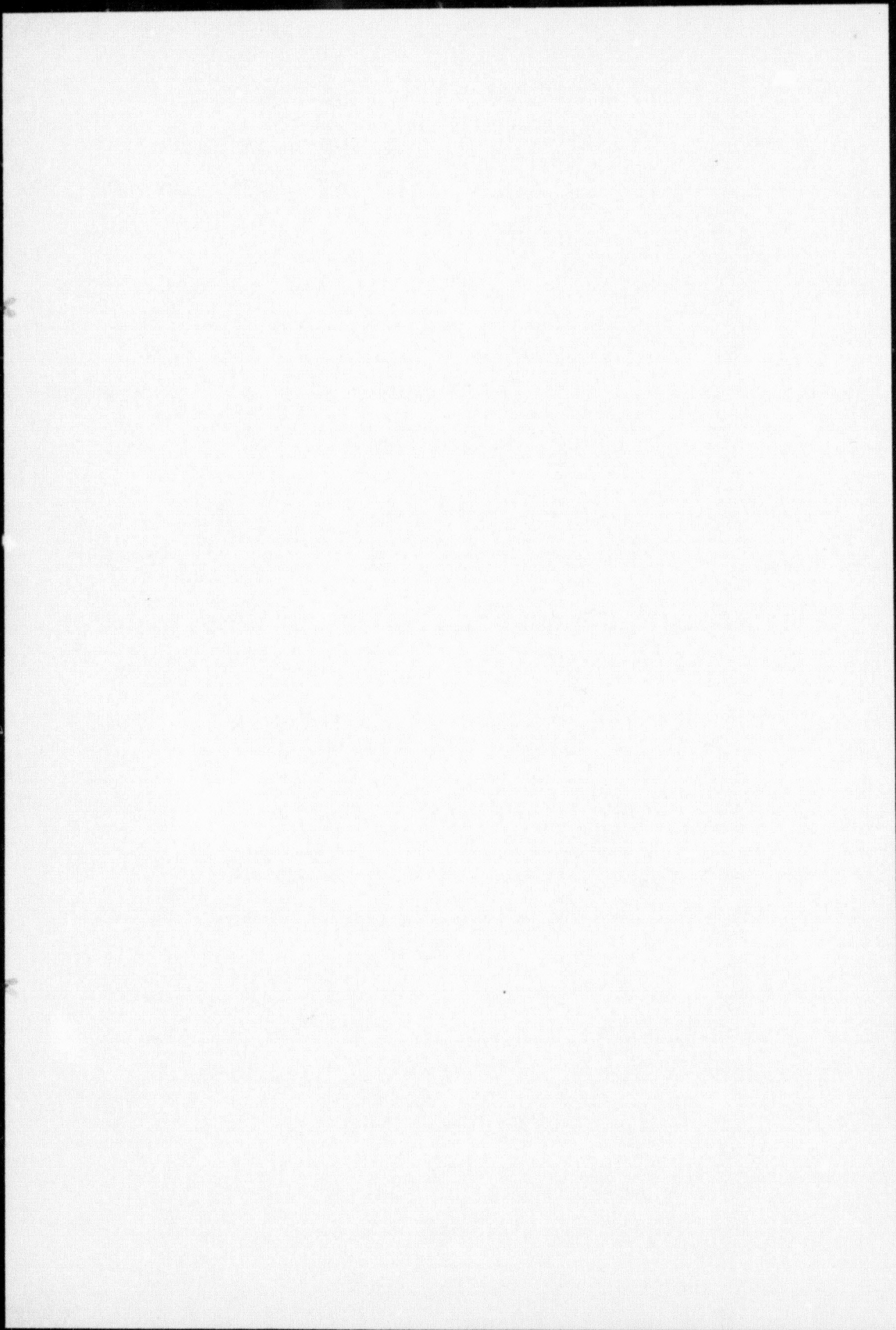


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—v.—

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REPLY BRIEF OF APPELLANTS

Preliminary Statement

This brief is submitted in reply to the answering brief of the appellee, Bristol Laboratories Division of Bristol-Myers Company ("Bristol"). Bristol's entire brief is grounded on two premises, neither of which withstands analysis. First, Bristol claims that it *excludes* from its prices on negotiated government contracts its costs for research and development, advertising and promotion and general administration and distribution. Second, Bristol claims that it is unique in excluding these major

cost items and accordingly that precedent * (in particular *Eli Lilly & Co. v. Staats*, 574 F.2d 904 (7th Cir.), *cert. denied*, 439 U.S. 959 (1978)) cited by the Government is distinguishable. In fact, as the record demonstrates, Bristol does not exclude such costs from its prices, and its pricing system is identical to other major pharmaceutical companies, including Eli Lilly & Co. ("Eli Lilly").

ARGUMENT

POINT I

Bristol Does Consider Its Major Cost Components In Setting Its Prices On Negotiated Contracts With The Government.

On this appeal Bristol asserts that in setting its prices to the Government on the subject contracts, not only does it not consider its costs for research and development, advertising and promotion, general administration and distribution, but also that it specifically *excludes* such major cost items in its pricing decisions. (Appellee's Brief at, *e.g.*, 2-3, 8, and 18). Further Bristol states that in setting its prices to the Government it considers only its estimated standard costs (*i.e.* direct manufacturing costs and manufacturing overhead), its own pricing of similar products, its historical bidding and its competitor's pricing. (*Id.* at 11).

In evaluating Bristol's contention, two facts about Bristol's accounting system must be considered. First, Bristol does not identify any cost by government versus

* Copies of another recent opinion upholding the Government's position on this appeal and rendered in a parallel case involving the drug company Smithkline Corporation will be furnished to the Panel. *SmithKline Corp. v. Staats*, Civil No. 75-499 (E.D. Pa. Jan. 24, 1980).

non-government contracts (A141) and, second, Bristol does not allocate any costs exclusively to non-government contracts. (A151). Moreover, the price charged the Government on negotiated contracts is Bristol's normal wholesale price. (A158). Accordingly, Bristol is literally saying that it does not consider major cost items, the records of which are the subject of this appeal, in setting *any* of its prices. Since Bristol aims to operate profitably (A162), that stance is clearly preposterous.

Wholly apart from the fact that Bristol's position defies logical scrutiny, it is refuted by the record in this case. As noted earlier, Bristol acknowledges that it does consider its historical pricing and its competitors' pricing in setting its prices to the Government and to its other customers. Bristol has admitted in the deposition of its Comptroller, Richard J. Cormier, that these historical prices do reflect its total expenses, *i.e.* They include research and development, advertising and promotion costs *etc.* Mr. Cormier testified as follows:

- Q. How do you make sure that the prices charged are sufficient to recover your costs and expenses and still have [sic] to make a profit?
- A. We can't determine this by individual products. We historically know what our total sales are, what our total expenses are. That's why many of our comparisons are made on some of our historical information insofar as what kind of prices succeeded in giving us a total overall profit in the division.

A 164-A165. Thus, directly or indirectly, Bristol is in fact considering the costs reflected in the disputed records in setting its prices to the Government. Accordingly, applying Bristol's own analysis the Government is entitled to access to the records in dispute:

Bristol agrees that a government contractor does not, for corporate accounting purposes, have to assign a particular cost to the contract in order for it to be "directly pertinent" if, in fact, the price it sets is calculated to absorb the cost in whole or in part.

Appellee's Brief at 25.

Finally, Bristol's argument appears designed to leave the impression that in purportedly "excluding" its major cost items from its pricing decisions, it does not intend to use revenues generated from government contracts to help pay for those costs. That is simply not so. Bristol makes no distinction in pricing government and non-government contracts and revenues from all contracts contribute to covering all expenses involved. (A167-A169).^{*} In short, as the *Lilly* court found on virtually identical facts, these costs "have a logical, causal and consequential relationship to a portion of the price of the products purchased by the Government" and therefore they "fit within the common and legal understandings of 'directly pertinent'." *Eli Lilly & Co. v. Staats, supra*, 574 F.2d at 914.

POINT II

The Case Authority Cited By The Government Is Directly On Point.

Bristol's second argument is that its method of setting prices is distinguishable from the approach utilized by other drug companies such as Eli Lilly and that therefore

^{*} Bristol repeatedly attacks what it refers to as the "bottom line" approach of the Government. It should be perfectly clear that the Government is not interested in a foray into Bristol's books and records, but has been compelled to examine more documents because of the accounting system that Bristol has chosen.

the Government's reliance on that case, and the others which have followed it, is misplaced. The fact is that Bristol and Eli Lilly, for example, utilize the same accounting system and the same pricing methodology. Bristol's attempt to avoid the consequences of "all-fours" authority in the Government's favor has also caused it to misstate the Seventh Circuit's opinion in *Lilly*.

Bristol and Eli Lilly utilize a full absorption manufacturing cost system, estimating standard costs and accumulating variances to those standards.* Eli Lilly, like Bristol, does not allocate its major cost items of research and development, and marketing and administrative expenses to individual products or specific contracts. Compare 574 F.2d 904 with A150. Eli Lilly, like Bristol, sets its prices to the Government on the basis of its general catalogue prices. Compare 574 F.2d at 907, 923 and 925 with A158.

With this factual background the district court in *Lilly* concluded that:

neither the negotiations nor performance terms of the contracts were in any way dependent upon, or directly related to, Lilly's costs of production,

* In the main the Government's discussion of Eli Lilly's accounting system is based upon the Seventh Circuit's opinion and the district court's findings in the *Lilly* case (incorporated by the dissenting opinion in the Circuit decision). If any questions remain we invite this Court to examine the Appendix to the Record in the *Lilly* appeal, which contains deposition testimony of responsible Eli Lilly officials and which is available in our office. The Court's attention is also directed to the affidavit of James D. Martin, Deputy Director of the Manpower and Welfare Division of the General Accounting Office (A105-A107) describing in general the accounting system utilized by all the drug companies that received requests for information from the Comptroller General. Bristol has not challenged that affidavit, which accurately describes its own system.

profits or methodology by which Lilly establishes its prices, including its standard catalog prices. Therefore, records relating to those types of information do not directly pertain to, and involve transactions relating to, the particular types of negotiated contracts involved in this suit.

574 F.2d at 925. In short, then, Bristol is trying to revive the approach followed by the District Court in *Lilly*, which was rejected for sensible reasons by the Seventh Circuit. The Seventh Circuit correctly perceived that the Comptroller General can only conduct a meaningful audit if he is afforded access to the records reflecting the major costs incurred by drug companies like Eli Lilly and Bristol.* Bristol's continued offer to provide to the Government only part of its costs with the assertion that the other costs are "unincluded" and that therefore its prices are fair, provides only cold comfort. Those costs *are* covered, in whole or in part, by the prices charged the Government and the Comptroller is entitled to full and accurate data as to the costs in accordance with the Congressional mandate.

* We note that Bristol has seriously misstated the *Lilly* court's findings at the top of page 17 of its brief when it states: "There the Court found that among Lilly's major items of cost in producing and marketing its products *to the government* were included some of those in dispute on this appeal, namely research and development." (Emphasis added). The *Lilly* court was in no position to comment on the specific expenditures of Eli Lilly for, as it noted, Eli Lilly did not allocate these costs to any particular product or individual contract. We note further that at no time has Bristol disputed the Government's position that the cost items which have generated this controversy are substantial. (A107).

CONCLUSION

The District Court's decision should be reversed and judgment entered for the Government granting the relief requested in its counterclaim.

Dated: New York, New York
February 28, 1980

Respectfully submitted,

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AFFIDAVIT OF MAILING

State of New York
County of New York

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Pauline P. Troia being duly sworn,
deposes and says that she is employed in the Office of the United States
Attorney for the Southern District of New York.

That on the
two copies

28th day of February 19⁸⁰

he served a copy of the within

appellant's reply brief

by placing the same in a properly postpaid franked envelope addressed:

Weil, Guttman & Davis
60 East 42nd Street
New York, N.Y. 10017

And deponent further says she

sealed the said envelope___and placed the same in the mail chute drop for mailing in the United States Courthouse Annex, One St. Andrews Plaza, Borough of Manhattan, City of New York.

Sworn to before me this

28th day of February, 1980

Pauline P. Trova

Joseph Lee

RALPH I. LEE
Notary Public, State of New York
No. 41-2292838 - Queens County
Term Expires March 30, 1981

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